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General Business Conditions

THE spectacular drop in prices of farm products has overshadowed all other business news during February. The reaction to it illustrates, earlier and more sensationally than expected, the paradox noted in the last issue of this Letter, which said that while people want prices to come down, they are made uneasy by developments threatening to depress them. The cost of living has become oppressively high. People are eager for relief. Farm products and foods have risen far more than most other prices, and a drop in these commodities eases the strain, weakens the arguments of the labor unions for wage increases, and offers hope of breaking the inflation spiral.

On the other hand, business men are nervous about prices. They wonder whether the drop may be the start of a general decline, liquidation, recession in trade and employment, and losses. Their memories of the 1920-21 drop are still vivid, and in January the wholesale commodity price index of the Bureau of Labor Statistics came within a hair of equalling the 1920 peak.

After a long rise in prices to levels which are historically very high, any turn in the markets may start a chain reaction. Nevertheless, last month's break was most pronounced in the commodities which had risen most since last August, and while it may turn out that the drop reflects and marks a change in general conditions, the immediate cause appears to be in the grain markets specifically. They declined in response to news, summed up in a later article in this Letter, which indicates that the grain scarcity, upon which the markets were bulled last Fall, will not be as acute as was then expected. Grain and feed prices influence livestock and animal products directly, and other markets sympathetically.

Farm Prices Out of Line

Between August of last year and the January peaks this year wheat in Chicago rose 71c per bushel, corn 37c, soybeans $1.10, cattle $3.12 per 100 lbs., lard 12c per lb., butter 18c. On the average, farm products rose 11 per cent. These advances not only pushed up the cost of living, but added further to distortions and maladjustments in price relationships which were already severe. On January 15, 1948, the index of prices received by farmers, compiled by the Department of Agriculture, was 223 per cent above the 1939 average. By contrast, prices of non-agricultural commodities had risen 80 per cent. Farm prices were too low in 1939, but the ratio of prices received to prices paid January 15, 1948 was 22 per cent higher than in 1910-14, which is the period upon which "parity" is calculated.

One effect of the farm price rise is that people have had to use an increasing share of their incomes for food. In the Bureau of Labor Statistics consumer price index, for example, which is based on the typical cost of living of city workers, food has lately represented 40 per cent or

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more of the total against the normal one-third. City people have had relatively less for other goods. As food prices work lower the balance will be redressed.

During the past month the August-January advances have been retraced in wheat, more than wiped out in corn, soybeans, and livestock, and partially retraced in the fats and oils. The decline in grains and commercial feeds not only signifies a better supply of grain at lower prices for our own people and for the Europeans who need it so badly; it also prepares the way, by providing cheaper feed, for a greater production of poultry and dairy products in the relatively near future, and of meats in the long run.

The Position of Farmers

The beneficial aspects of the market break are recognized in most current comment. It also has to be considered that all such breaks cause actual or paper losses or reduction of income to someone, and hence may have direct effects on trade and industrial employment and income. However, it is safe to say that there is no other broad area in which prices could decline as sharply with as little shock to business as a whole.

Livestock feeders who paid high prices for feeder cattle, and fed them on $2.50 corn, experience losses at once. But for the most part the effect of the drop in value of livestock and crops held on the farms is to wipe out or reduce paper profits which could not have been generally realized in any case. All the ground lost by the markets had been gained in the past five months, and the situation is not as if the peak prices had prevailed over a period of years, capital values had been written up proportionately, and a body of debt had been created whose goodness depended upon maintaining the peak prices. None of these is the case. Processors and distributors who have inventories of farm products at prices now above the market have losses, but the general testimony is that they can be absorbed in the normal turnover and covered by current profits or reserves without material effect on productive activity.

Farmers as a whole will feel poorer, and they will receive a lower income in 1948 if prices stay down. Their purchasing power will drop accordingly. However, their average prices received are still as good as those of last August; and they have assurance in the law that the Federal Government will lend them 90 per cent of parity on most of their products, if prices go that low. Lower grain prices benefit many farmers, such as dairymen, poultrymen and all who buy feed.

Farmers have had greater increases in income than other groups of the population and their financial position is the strongest on record. They had cash income of $30.5 billion in 1947 and $25.3 billion in 1946, against $9 billion or less in the immediate prewar years. Their net income after all production expenses, including interest and wages paid, is estimated at $18 billion in 1947, compared with less than $4 billion in each of the years 1938, 1939 and 1940.

At the beginning of 1947 their cash on hand, bank deposits and U. S. Savings Bonds totaled $20.5 billion against $4.1 billion January 1, 1940, and their total debts including mortgages amounted to only $8.3 billion against $10 billion. The figures are from the Bureau of Agricultural Economics. During 1947 their debt increased somewhat, but their liquid assets probably rose another $1.5 billion.

These figures should carry weight in judging the effects of a prospective drop in farm income on non-farm business. Farmers have reason to expect in 1948 a cash income comparing favorably with 1946, at least, even though down from 1947. They have a store of savings which justify them in spending current income freely. They have the means to buy equipment and the other durable goods they need and have been waiting for. We venture the opinion that farmers themselves – while having to adjust their expectations and look afresh at their operating costs – see in the prospect nothing with which they cannot cope, and little reason for gloom.

The Industrial Situation

The main question is whether the reaction will become general. After an event of possibly momentous implications, it is natural to expect that buyers may hold off until they think the situation is clarified. They see other reasons for caution, including the observation that more goods are getting in a normal supply position and that consumers have more choice, which means increased competition.

There is evidence that the break has been followed by smaller buying at wholesale, and even at retail. Shoe people think some curtailment may be in prospect after the Easter trade is supplied, and spot prices for cotton print cloths, which have been commanding stiff premiums over mill contracts for forward delivery, have tumbled. Cotton mills, however, are sold months ahead. Prices on fall lines of woolens and worsteds have been raised.

Automobile markets are difficult to judge because it is not clear to what extent recessions in used car prices and in resale premiums on new cars are purely seasonal. Evidently producers of some of the highest priced cars are catching up

with the market, but the opinion that all the lower and medium priced cars which can possibly be produced this year can be sold finds almost no dissent. The situation in most durable goods industries is unchanged. No slackening in railway, electrical and petroleum equipment, farm equipment, or in textile and mining machinery is at hand or in sight. In some household appliances the current output is adequate, but many of the best-known brands, which consumers prefer, are still hard to get.

Metal Prices Significant

Considerable significance can be attributed to what happens in metal markets in the weeks ahead, for metal prices provide an indicator of demand conditions in a great number of diverse industries. No easing in the demand for steel is reported. The recent steel price advances have caused more discussion than they deserved, in view of their limited character, and in the heat of controversy probably too little attention has been given to the aspect that may be most significant in its bearing on business conditions, namely, the affirmation that the trend of costs is still upward and that needs for most kinds of steel are still of the utmost urgency. "Gray market" prices for rolled products have made new highs.

Copper and brass are reported easier to get, and scrap copper has declined ¾c during the month. Primary markets have not weakened, however. The country will need to import copper until there is a major slump in home demand, and world markets are firm, with Great Britain recently paying more than the U. S. price for South American copper. The lead and zinc markets have continued strong.

In short, any summary of the industrial news reveals both spotty softening and great strength. It seems to deny the probability of any considerable recession in industrial operations in the months just ahead, while leaving the outlook thereafter dependent on the attitude of business men and the course of the markets this Spring.

Both this country and the rest of the world are far in arrears in construction work and in production of wanted goods. Other countries will buy here all they can, and calculations of the amount of dollars that will be available to them during 1948, including the likely appropriations under the European Recovery Program, warrant the opinion that our exports in 1948 will show no more than a modest decline under 1947.

The volume of construction under way and contemplated is larger in the aggregate than a year ago. Fear that plans may be laid aside because of high costs or tightening of mortgage money is appearing, but to what extent it is justified remains to be seen. The needs are acute; if costs are too high they must come down.

The Wage Demands

Even though analysis of the outlook may lead to optimistic rather than pessimistic conclusions, no extended discussion should be necessary to show that the demands for third round wage increases, which the union leaders are going ahead with, are untimely. If they are successful the effect will be to raise prices of manufactured products, for even if the best situated employers absorb the increased costs, many cannot. It is hardly likely, with the uncertainties now felt, that wage increases and higher prices for manufactured goods would be interpreted as bullish, as was the case last Spring. More probably they would cause fresh uneasiness. The inflation has run nearly a year longer, prices are substantially higher, pipelines are better filled, and competition is keener.

Farmers face adjustments and they are likely to want to know what contributions other groups of the population are making toward stopping inflation and what the prospects are for bringing down prices of things they buy as well as of things they sell. They cannot be happy to observe that while they receive 60 or 70c less for wheat and corn and $5 or $6 less for livestock they will have to pay more for men's clothing next Fall largely because wage increases, only recently effective, have forced up prices of woolen goods. They may ask with reason whether they are expected to suffer deflation of their purchasing power both by receiving lessened incomes and by having to pay more for manufactured goods, while factory workers get increases in money incomes and lower food prices as well.

Wage increases are inflationary as long as the resulting price increases can be passed on without curtailment of sales, production and employment. If the price increases cannot be passed on the wage increases will be deflationary for they will restrict sales and employment. The objective now to be sought is stability. Declines in prices that were out of line improve the situation. Forcing up of other prices will disturb it and leave it more vulnerable to general reaction.

In any consideration of the business outlook it cannot be forgotten that we live in a disturbed and uncertain world in which portentous events, unpredictable in nature or in timing, occur with shattering frequency. Some are inflationary,

some deflationary. In the end the story of what happens to business is likely to be told in terms of these events and their influence, rather than in terms of the factors which can now be weighed and measured.

The Decline in the Grain Markets

The break in the grain markets was the climax of an adjustment of prices to an improved world food situation, and reaction in feed prices which had become too high in relation to livestock. World food supplies have been increased by a bumper wheat harvest in the Southern Hemisphere, a larger Oriental rice harvest, and lower than expected wheat feeding to animals in the United States. The last-mentioned factor has released possibly 100 million bushels more for human consumption than had been counted on earlier in the season. At the same time, Russia and Eastern Europe became unexpectedly heavy sellers of grains to Western Europe.

The effect of these changes has been to revise upward the estimates of this season's world exportable grain supply from around 28½ million tons last Fall to a current figure of 32 million tons. The gain of 3½ million tons has closed about half the gap between needs and supplies caused by the 7½ million ton decline in last year's European bread grain crops. The recent Oriental rice harvest showed a gain of about 2 million tons over last season, which will indirectly release more grains for Europe.

World Grain Prospects Improve

Accompanying the improvement in supplies, and an equal influence in the price decline, has been the steady improvement in the new crop outlook both here and in Europe. The start was shaky here last Fall, when for a time it looked as though considerable winter grain acreage would not be seeded because of drought.

The turning point came with the heavy rains around the middle of November. In December came confirmation that the gamble of seeding in dry soil had been won, together with the disclosure that winter wheat acreage would establish an all-time record. A good snow cover has given protection during the Winter, at the same time providing surface moisture for a good start when the wheat plant emerges from the dormant stage. Late in January, when mid-season wheat stocks in all positions were revealed, came proof that wheat feeding to animals was being held down to normal levels, easing earlier fears. Meanwhile, the outlook for next year's European crops also grew progressively brighter, starting with good rains late in the Fall, the seeding of the largest winter grain acreage since the war, and finally an extremely mild winter, in marked contrast to the unusual winter-killing and heavy acreage abandonment last year.

If crops in Europe and North Africa should hold their present condition, international authorities have estimated tentatively that this year's harvest could approach 1.5 billion bushels or about 85 per cent of prewar. This would compare with last year's less than 1.1 billion bushels. While Europe still will need to import much more grain than before the war, by reason of increased population and depleted reserves, the drain on exportable supplies next season should be far less urgent than this season.

It should be noted that the crop scare stage is just ahead. Both here and in Europe, crops this year are in a condition which makes them unusually vulnerable to an unfavorable twist of the weather. It thus is too early to be sure that we are completely out of the woods.

C.C.C. Buying Program

Three factors will increasingly dominate the price of wheat over the next few months. One is the price of corn, which has recovered about 25 cents of its 80 cents decline since mid-January. The other two are the development of the new crop after it emerges from its winter dormant stage, and the amount of wheat purchased and exported over the next few months by the Commodity Credit Corp. To a considerable extent, the latter will be determined by the former.

At the end of February, 67 million bushels of wheat and flour equivalent remained to be purchased to complete the Cabinet Food Committee's 450 million export goal, which was reduced from 500 million early in January. If the total amount of wheat fed to animals during the crop year does not exceed 200 million bushels, which would allow twice as much to be fed during the second half of the season as was fed during the first half, the wheat export goal could safely be raised back to 500 million, at the same time assuring a minimum carryover of 150 million bushels next July 1. Secretary Anderson has stated that the Cabinet Food Committee will decide the question of stepping up the export goal late in March, in the light of the new crop outlook at that time.

Effects On Livestock Outlook

The rise and subsequent decline in grain prices this season is being felt in the markets for livestock and livestock products, where adjustments

are taking place which will affect future meat, dairy and poultry supplies. The sharp rise in grain prices to the January peaks resulted in the slaughter of hogs at lighter weights, a lower degree of finish, and a much lighter run of cattle into the feed lots, while at the same time cutting down the rate of egg and milk output per animal. The effect of the unprofitable egg-feed ratio is shown in the fact that on February 1 the number of chicks on order was 28 per cent less than a year ago.

Already, there is evidence that the decline in grain prices has started a reversal of some of these trends. Market weights of hogs since the last week in January have been running close to record highs and somewhat heavier than a year ago whereas from September through December weights averaged 5 to 15 lbs. lighter than a year ago. Demand for baby chicks has started up again and hatchery demand has contributed to the recent contra-seasonal rise in the egg market. Previously, there had been a sharp decline in hatchery demand for eggs following the short corn crop. However, the pressure of unusually heavy cold storage pork stocks competing with fresh supplies, and consumer resistance to pork products at recent peak levels, has kept hog prices so far from showing any improvement in relation to corn prices, thus discouraging hopes for any marked rise in breeding plans for the fall pig crop.

Credit Developments

In the area of bank lending, the sharp reaction in the commodity markets, following so closely upon the successive steps taken by the Federal Reserve and Treasury authorities to discourage excessive bank credit expansion, served to reinforce caution. In the capital markets, stock prices suffered a sympathetic downward reaction, while the bond market, with the benefit of continuous Federal Reserve support for the government list, showed an improved tone. A number of new bond offerings were successfully distributed.

Meanwhile, the flow of surplus tax revenues into Treasury coffers drew against checking account deposits, and put the banks under the necessity of selling government securities to make up their losses of reserves. The Treasury continued its deflationary policy of focussing surplus revenues so far as possible on retirement of Federal Reserve-held debt.

Since the turn of the year bank loans have been extended at a rate which evidently has little more than offset repayments of old loans. All classes of loans on the books of the weekly reporting member banks increased no more than $124 million between December 31 and February 18 and this increase was entirely accounted for by interbank loans which represent temporary borrowings of reserves by one bank from another. Other loan items offset each other. Real estate loans were enlarged further – though at a definitely slackened rate – while security loans showed a net decrease. Commercial, industrial and agricultural loans – the broad category of "business loans" – were slightly smaller on February 18 than they had been in December.

It thus appears that bank lending has not been actively inflationary in this period. Treasury surplus revenues have been effective in reducing the supply of money in the hands of individuals and the business community even though offset in part through the selling of government bonds by bank customers and the public in general. These bond sales, to the Federal Reserve Banks at their fixed support prices, provided the means for replenishing bank deposit balances and reduced the amount of government securities the banks were under the necessity of selling to meet deposit losses.

The net result was a substantial deposit shrinkage. Over the December 31-February 18 period checking account deposits on the books of the weekly reporting member banks were reduced $1,276 million and their government security holdings $593 million.

Bond Purchases Slow Up

Federal Reserve price-supporting purchases of government bonds slowed up during February, as the drop in commodity markets suggested to many people a reduced demand for credit and so less pressure on the bond market. During the month many of the fully taxable issues unrestricted as to bank ownership were quoted a shade or better above the official support levels. The partially tax-exempt issues also rallied.

The Federal Reserve Banks added $1,127 million to their holdings of Treasury bonds during the four weeks ended February 25 and of this amount $1,017 million were classified in the category of over five years to maturity. Much smaller purchases were made for Treasury investment accounts. Presumably, the official supporting operations during February were rather heavily concentrated on War Loan drive 2¼ and 2½ per cents, issues which the commercial banks are not eligible to buy. These issues have held at the support levels quite consistently as non-bank investors have taken advantage of the opportunity to turn them into cash, in favor of other invest-

ment outlets that have appeared more attractive, or in favor of shorter-term government securities. Short-terms—Treasury bills, certificates and notes—in the Federal Reserve portfolio have been reduced not only through sales to meet this demand, but also and to a greater extent through redemptions at maturity. Thus, despite the large volume of bonds the Federal Reserve Banks have purchased, their total holdings of government securities have declined.

Sources of Bond Selling

With total purchases in support of government bond prices now nearing the six billion dollar mark, the question is pertinent as to where all these bonds have been coming from. The Treasury Department's monthly Survey of Ownership of government securities will provide a substantial answer some months hence when the data for December through February will have been tabulated and made available. Meanwhile, the weekly Federal Reserve Bank statements, together with the Treasury daily statements and the weekly reporting member bank data, afford the basis for at least a preliminary analysis through February 18.

The following table, constructed from these sources, shows the magnitude of the bond supporting operations and casts some light on where the bonds have come from and the uses made of the proceeds of sale:

Changes in Ownership of Government Securities
(In Billions of Dollars)

	Nov. 5, 1947-Dec. 31, 1947	Dec. 31, 1947-Feb. 18, 1948	Nov. 5, 1947-Feb. 18, 1948
Treasury Bonds			
Federal Reserve Banks	+2.1	+2.7	+4.9
Treasury invest. accounts	+0.9	*	+0.9
Weekly rep. member banks	—1.5	—0.9	—2.4
Other investors	—2.3	—1.8	—4.1
Total outstanding	—0.7	—	—0.7
Treasury Bills, Certificates, and Notes			
Federal Reserve Banks	—1.7	—4.3	—6.1
Treasury invest. accounts	*	*	*
Weekly rep. member banks	+0.7	+0.4	+1.1
Other investors	+0.6	+1.2	+1.8
Total outstanding	—0.3	—2.8	—3.2
Total Government Securities			
Federal Reserve Banks	+0.4	—1.6	—1.2
Treasury invest. accounts	+0.9	*	+0.9
Weekly rep. member banks	—0.8	—0.6	—1.3
Other investors	—1.6	—0.6	—2.3
Total outstanding	—1.0	—2.8	—3.8

*Estimated change less than $50 million.

NOTE: Figures are rounded and do not necessarily add to totals shown.

The $5.8 billion bonds purchased by the Federal Reserve Banks and Treasury investment accounts over the November 5-February 18 period evidently came out of the portfolios of weekly reporting member banks to the extent of something over one-third, and out of the portfolios of other investors to the extent of nearly two-thirds. The "other investors" group includes nonreporting banks, as a lesser factor, but is more heavily weighted by the transactions of insurance companies and mutual savings banks, as well as private pension funds, corporations and associations, and individuals.

On the other hand, Federal Reserve holdings of Treasury bills, certificates and notes, as shown in the second section of the table, were reduced $6.1 billion. Public debt redemptions, heavily concentrated on Federal Reserve Bank holdings, accounted for over half of this drop. The Reserve Banks also supplied market demands for bills, certificates, and notes arising partly from the weekly reporting member banks but more largely from other investors.

As the final block of the table indicates, the Reserve Banks were able to reduce their holdings of governments by $1.2 billion net, over the November 5-February 18 period as a whole, thus keeping pressure on bank reserves.

The Public's Power to Inflate the Money Supply

The $2.3 billion net drop in government holdings of other investors represents principally proceeds from the sales of bonds, by nonbank investors, which have been employed for loans or investments through other channels with the incidental effect of replenishing bank deposits. This provides a rather striking illustration of how, when the Reserve Banks are standing ready to buy government securities in any amount, the public at large has the capacity to increase the money supply and inflationary pressures. In this process, the commercial banks have the passive role of clearing the payments and accepting the deposits created through the Federal Reserve purchases.

The inflationary influence of Federal Reserve purchases of government securities thus have served to undo a part of the deflationary influence of the Treasury tax collections.

Many people are asking the question as to what Treasury and Federal Reserve policy may be in prospect for the second quarter, when the peak of tax collections will be past. Those moves will be dependent upon appraisals of the business and price outlook, as it unfolds. The authorities have an impressive armory of weapons to choose from if the problem is again one of curbing inflationary pressures. As one immediate resource, Government balances accumulating on deposit with the commercial banks, from the proceeds of sale of Savings bonds and notes, can be drawn out to put pressure on the banks. The most basic control, of course, lies in the structure of Federal Reserve support levels for government securities. These levels can be modified to establish or en-

large penalties to the seller. We have seen that even very modest moves of this sort can have solid effects.

Industrial Corporation 1947 Reports

Annual reports now being published for 1947 reflect a banner year for earnings in the manufacturing industries. Notwithstanding sharply rising costs, earnings increased substantially over 1946 to establish new high levels along with national income, employment and wages, farm income, exports, and numerous other evidences of a booming economy.

Despite these high earnings, the corporate balance sheets reveal that a substantial increase in borrowing was necessary to handle the tremendous volume of business and to finance at current high costs needed improvements in productive facilities. Although only around half of last year's net income was paid out in dividends, the balance of undistributed earnings was more than absorbed by increases in plant and equipment, inventories, and receivables, thereby forcing additional financing which under the conditions prevailing in the equity market was mostly in the form of debt.

Contrary to the situation during the first half of 1946 when business, especially in the durable goods industries, was plagued and retarded by strikes and reconversion problems, production during 1947 forged ahead at high levels without major interruptions. Not only was there an absence of paralyzing labor disputes, but business, having largely completed its reconversion job, was in a position to "go to town" in meeting the accumulated wants of the American people.

While earnings were benefitting from high volume, other factors were influential:

1. Removal of price controls late in 1946 made it possible for business concerns to adjust more readily to rising costs, and to widen profit margins which in many cases had been held abnormally low by wartime price regulations.

2. Rising prices, while they meant rising costs, also brought windfall inventory profits — a risky and impermanent gain, but one that nevertheless bulked large in the year's results. According to Department of Commerce figures, against the much-quoted estimate of $17 billion for total earnings after taxes (or $28 billion before taxes) of *all* corporations for 1947, approximately $5 billion (before taxes) was estimated to be of this character.

3. Repeal of the wartime corporate excess profits tax and lowering of the normal tax. While this tax relief first applied in 1946, it was not until the record-volume business of 1947 that the full effects upon earnings became apparent.

What the Figures Show

Reflecting these various influences, our preliminary tabulation covering the annual reports of 960 manufacturing companies for the 1947 calendar or fiscal year shows combined net income after taxes of approximately $3,202 million, an increase of 50 per cent over 1946. Total sales volume of the companies reporting sales for 1947 rose approximately 42 per cent over 1946 to a new high record.

Analysis of earnings figures available quarterly shows that most of the increase over 1946 occurred during the first half year, as indicated by the following table. Figures for that period compare, as noted above, with a half-year of reconversion, strikes, and materials shortages in 1946, when some of our best-known and strongest corporations operated in the red.

Net Income After Taxes of 400 Large Manufacturing Corporations

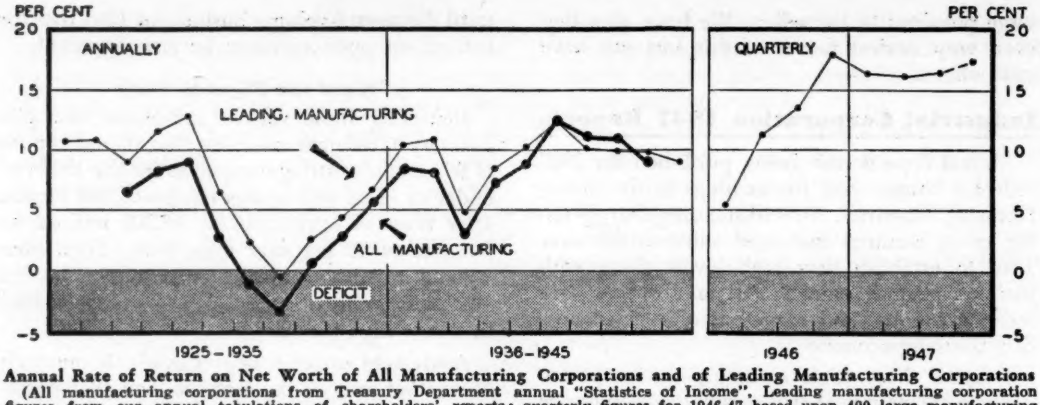
	1946	1947	% Change
March Quarter	$267,304,000	$881,528,000	+230
June "	558,683,000	876,637,000	+ 57
Sept. "	673,423,000	885,941,000	+ 32
December "	880,492,000	Pre. 950,000.000	+ 8

As shown by these quarterly data, the rise in earnings levelled off after the final quarter of 1946, with the horizontal trend holding to the fourth quarter of '47 when a further moderate increase appears to have taken place.

The chart on the following page gives the quarterly comparisons during 1946-47 in terms of annual rates of return on net worth; also the annual comparisons for a larger group of leading companies in prior years, together with the average rate of return for all manufacturing corporations in the United States, computed from the official Treasury statistics from 1927 through 1944, the latest year available.

Net worth of the 960 leading companies totaled $18.7 billion at the beginning of 1947, upon which the year's net income represented an average return of 17.1 per cent, compared with a net worth of $17.1 billion in 1946 and a return of 12.5 per cent. The return last year exceeded the previous peaks shown in our similar tabulations of 12.8 per cent in 1929 and 12.4 per cent in 1941, as shown in the chart, and compares with a 22-year average 1925-46 of 8.4.

Despite the sharp rise in the composite earnings, and the prevalence of plus signs in major industry groups, about 23 per cent of the individual companies reported decreases last year, and 5 per cent incurred net deficits, even after allowance for carryback tax credits.



Annual Rate of Return on Net Worth of All Manufacturing Corporations and of Leading Manufacturing Corporations
(All manufacturing corporations from Treasury Department annual "Statistics of Income". Leading manufacturing corporation figures from our annual tabulations of shareholders' reports; quarterly figures for 1946-47 based upon 400 large manufacturing corporations, with latest quarter preliminary.)

The accompanying table gives a preliminary summary by major industrial categories of net income, net worth, and rate of return for the past two years. Our final summary to be given next month will comprise a much broader sampling of the manufacturing companies available at that time, divided into smaller sub-groups and giving profit margins on sales as well as return on net worth, together with figures for corporations in the fields of mining, trade, transportation, public utilities, service, and finance.

Profits and "Profiteering"

No doubt the figures on corporate earnings will continue to be denounced by many people as "excessive", "extortionate" and the like. It is questionable how many of those who make these charges are either without an "ax to grind", or are really familiar with the record and have any clear idea as to the dividing line between profits and "profiteering".

It is true that the estimated total of $17 billion of profits (after taxes) of all American corporations in 1947 is a lot of money; but it may be noted that these represented a margin of but 5½ cents per dollar on a gross business aggregating around $300 billion. Nor is the mere fact that profits are record-breaking and showing a large percentage of increase over prewar prima facie

PRELIMINARY SUMMARY OF MANUFACTURING EARNINGS IN 1946 AND 1947
Net Income is Shown as Reported — after Depreciation, Interest, Taxes, and Other Charges and Reserves, but Before Dividends. Net Wo th Includes Book Value of Outstanding Preferred and Common Stock and Surplus Account at Beginning of Each Year.
(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Net Income After Taxes 1946	Net Income After Taxes 1947	Per Cent Change*	Net Worth, Jan. 1 1946	Net Worth, Jan. 1 1947	% Return 1946	% Return 1947
15	Baking	$ 44,254	$ 44,942	+ 1.6	$ 225,001	$ 241,448	19.7	18.6
18	Meat packing	67.726	83,353	+23.1	655,149	689,361	10.3	12.1
20	Sugar	28,847	64.441	+ —	239,234	270,489	12.1	23.8
47	Other food products	138,006	191 897	+39.0	772,250	870.575	17.9	22.0
45	Beverages	161,809	164,503	+ 1.7	490,414	625,619	33.0	26.3
17	Tobacco products	90,701	104,683	+15.4	765,912	797,550	11.8	13.1
35	Cotton goods	61.938	113,799	+83.7	245.843	279,842	25.2	40.7
55	Other textile products	132,537	181,291	+36.8	577,307	670,408	23.0	27.0
26	Leather and shoes	24,033	38,042	+58.3	226,293	245.131	10.6	15.5
18	Rubber products	124,952	112,173	—10.2	611,211	692,034	20.4	16.2
36	Pulp and paper products	61,831	116,557	+88.5	472,848	548,678	13.1	21.2
39	Chemical products	256,485	319,182	+24.4	1,717,713	1,843,879	14.9	17.3
13	Drugs, soap, etc.	55,290	59,779	+ 8.1	281,213	331,625	19.7	18.0
11	Paint and varnish	19,946	34,059	+70.8	131,169	143,390	15.2	23.8
21	Petroleum products	88,775	150,086	+69.1	899,939	966,900	9.9	15.5
44	Cement, glass, stone products	76,109	101,506	+33.4	609,857	669,489	12.5	15.2
36	Iron and steel	259,712	409,478	+57.7	3,509,694	3,623,323	7.4	11.3
12	Agricultural implements	45,551	90,827	+99.4	694,668	731,416	6.6	12.4
38	Building, heating, plumbing equipment	32,117	62,985	+96.1	276,740	317,966	11.6	19.8
39	Electrical equipment and radio	46,620	131,956	+ —	732,732	860,055	6.4	15.3
34	Machinery	46,146	93,791	+ —	523,081	567,519	8.8	16.5
11	Office equipment	25,972	38,979	+50.1	132,059	155,917	19.7	25.0
101	Other metal products	67,784	117,311	+73.1	504,051	555,727	13.4	21.1
55	Automobiles and parts	33,984	197,718	+ —	663,877	792,985	5.1	24.9
14	Railway equipment	27,569	41,406	+50.2	323,857	343,200	8.5	12.1
13	Aircraft and parts	8,319	D-18,201	— —	124,855	127,177	6.7	—
97	Misc. manufacturing	104,565	155,621	+48.8	698,701	782,600	15.0	19.9
960	Total manufacturing	$2,131,578	$3,202,164	+50.2	$17,105,668	$18,744,298	12.5	17.1

D- Deficit. * Increases or decreases of over 100% not computed.

evidence of anything wrong. So are a great many other things "record-breaking" and greatly enlarged over what has been considered normal in the past. So are factory wage payments, up 106 per cent over prewar; farm income, up 285 per cent; bank demand deposits, up 197 per cent; and so on.

At a time now when the national income is at a rate approaching three times the 1939 total, the question is well asked, what, then, should we expect aggregate profits to do? Without attempting to justify profits in all individual cases, it is significant that so far as the overall total is concerned a $17 billion total corporate net income would be but 8.5 per cent of last year's national income of $203 billion. In prewar years of active business, the ratio was 9.6 per cent in 1929, 6.4 per cent in 1937, and 9.1 per cent in 1941.

The foregoing is by no means intended as a "whitewash" of all business pricing policies, but the conditions that give rise to unusual profits should be understood.

The "High Cost of Corporate Living"

In all that is said about "corporate greed" and high prices, it is well to bear in mind that there is such a thing as the high cost of living for the corporations and their shareholders as well as for everybody else.

Corporate shareholders do not usually get much sympathy, on the theory that they are nothing but "old money-bags" anyway. Actually, they include hundreds of thousands of persons in modest circumstances, as well as schools, colleges, hospitals, and charitable institutions of all kinds. The dividend payments have of course been increased by many companies but in the aggregate have barely kept pace with the increase since prewar in the cost of living. On the other hand, total corporate wage and salary payments have increased much more than dividends, and average weekly earnings of factory workers stand well ahead of the rise in the cost of living since prewar.

Moreover, the corporations themselves are finding that a dollar does not go nearly so far now as it used to. According to a recent study by the National Industrial Conference Board, the purchasing power of the consumer's dollar in August 1947 was 66 cents, in terms of the 1935-39 average as 100, as compared with 45 cents for the raw materials dollar and 53 cents for the construction dollar. The manufacturer, continues the study, must now pay more than twice as much for an hour of labor as during 1935-39.

One example, among many that could be cited, of the greatly increased cost of the mere process of carrying on current business was disclosed at the recent annual shareholders' meetings of Armour & Company. Comments by George A. Eastwood, chairman, on increased working capital requirements were summarized in the press as follows:

> One of the most immediate considerations is the heavy requirement for working capital to carry higher cost inventories. They are the highest they have ever been. Hogs which the company used to buy for $17.50 in 1939 have cost up to $65. Steers that could be bought for $100 in 1939 have been costing up to $300. Our prewar inventory of products – in other words the amount that we need to fill our pipe lines of distribution – stood at about $75,000,000. With approximately the same tonnage of product in our pipe lines at the end of the 1947 fiscal year our inventory represented a value of about $146,-000,000.

On the matter of the increased cost of plant modernization and expansion, the following quotation, referring to the increased earnings of the Socony-Vacuum Oil Company last year, by H. F. Sheets, chairman, and B. B. Jennings, president, is pertinent:

> Unless fully understood this appears to be a large increase. In fact, however, because of the effect of inflation, the figures though arithmetically correct require interpretation. For example, depreciation reserves, based as they are on original costs of plant, are grossly inadequate to replace that plant at today's costs which are 50% to 200% higher than prewar. Furthermore, because all oil companies must expand facilities in order to meet the large demand for oil products (currently 140% of prewar), an abnormally high proportion of earnings must be ploughed back in the business.

Balance Sheet Changes

These heavy requirements for capital last year, despite high earnings, are reflected in the balance sheets given in the corporate annual reports. We give on the next page a statement for 140 manufacturing corporations, each having sales or total assets over $5 million, showing the changes in condition since the end of the war as well as since 1940 Total sales and other revenues of these companies in 1947 aggregated around $11.8 billion. Although this composite statement shows the results of an important group of large companies, it necessarily covers only a small sample of the total manufacturing industry and may not be representative of many intermediate and small corporations.

During last year there was an absorption of funds amounting to $500 million for modernization and expansion of plant and equipment (after $101 million depreciation reserve), also $339 million for carrying increased inventories, and $167 million for increased receivables, making total requirements of $1,006 million.

This was financed principally by an increase of $283 million in bonds, notes, mortgages, etc.

Composite Balance Sheet of 140 Manufacturing Companies with Sales or Total Assets over $5 Million

(In Millions of Dollars)

Assets	December 31 1940	1945	1946	1947
Cash	$ 552	$ 749	$ 691	$ 790
Government securities†	64	757	517	492
Receivables, net	436	795	818	985
Inventories*	1,117	1,728	2,165	2,504
Total current assets	2,169	4,029	4,191	4,771
Land, plant & equipment	3,453	3,832	4,241	4,842
Less depreciation	1,623	2,259	2,358	2,459
Net property	1,830	1,573	1,883	2,383
Other assets	426	365	405	403
Total assets	4,425	5,967	6,479	7,557
Liabilities & Capital				
Notes payable	57	188	233	197
A/c pay., accruals, etc.*	334	639	675	775
Reserve for taxes†	210	663	465	626
Total current liabilities	601	1,490	1,373	1,598
Bonds, notes, etc.	521	420	712	1,031
Reserves	140	304	271	351
Capital and surplus	3,163	3,753	4,123	4,577
Total	4,425	5,967	6,479	7,557
Working capital	1,568	2,539	2,818	3,173
Current ratio	3.61	2.70	3.05	2.99

† Before deducting tax notes offset against taxes payable.
* Includes advances on government contracts.

(short- and long-term), an increase of $261 million in other current liabilities (tax reserve, accounts payable, accruals, etc), and an increase (mostly from retained earnings) of $454 million in net worth.

But for the earnings ploughed back into the business last year, these companies would – in view of the difficulty in raising new equity capital – have been forced to increase their debt even more. Had dividend payments, which including both preferred and common amounted to around one-half of net income, been reduced in order to conserve more funds for corporate purposes, the difficulties of attracting new money would have been further increased.

Although net working capital continued the growth shown in previous years since end-of-war 1945 and prewar 1940, the current assets are now more largely in the form of inventory, which is subject to wide price fluctuations as recently demonstrated by the breaks in some of the commodity markets, and less in the form of cash and government securities.

Unless corporations are able to keep their capital structures in balance, either through earnings or the sale of new stock to investors, they become more vulnerable to downswings in the business cycle, and more dependent upon bank borrowing with its inflationary consequences upon the general situation.

These are all illustrations of the increased cost of living for corporations, which in the case of the railroads and some branches of the public utility industry is being recognized by the governmental regulatory authorities as justifying higher rates. Large earnings for the manufacturing companies should be viewed in the light of the changed costs to business organizations of performing their essential services to society.

State and Municipal Finance

With federal government expenditures for the fiscal year beginning next July projected in the President's budget at a total close to $40 billion, which Congress has voted to pare down to the still vast sum of $37.2 billion, interest also attaches to the expenditure plans of the states and local governmental units. Altogether these 155,000 separate government organizations, including counties, cities, towns, and school districts, collect in taxes over $10 billion a year, and the total of their disbursements for current running expenses plus capital outlays represents an important element in the sum total of government costs as well as in the demand for goods and services.

A review of the financial activities of the states and municipalities for the calendar year 1947 discloses bond issues for new money totalling over $2.3 billion, approximately double the $1.2 billion in 1946 and by far the largest ever recorded. While no complete analysis of the purposes of these issues is available, borrowing by several states for payment of bonuses to veterans of World War II bulks large. Illinois, Michigan, Massachusetts, Connecticut, and others raised for this purpose a total of $630 million, the greater part of which has been paid to veterans in cash.

Many states during the war years set aside substantial amounts of their surplus revenues to finance improvements after the war, when materials and labor should again become available and when, as then generally believed, the spending power represented by such funds would be a welcome addition to the national business volume. A supplementary purpose was to catch up on such public improvements without an accompanying rise of debt.

While the state governments have not rushed into the execution of capital spending programs, and their postwar reserves apparently have not yet been materially reduced, nevertheless the war bonus financing previously mentioned has already reversed the wartime downtrend of bonded indebtedness. Local government debt also increased during 1947. In both cases the totals are still below prewar peaks.

Scanning of municipal and other government loans reveals little ground for criticism of their purposes, if considered apart from the generally inflationary effect of the sharp increase in pub-

lic spending. There appear few instances of borrowing for non-essentials, although some of the approved undertakings may be extravagant in design. The need for repairs and new construction of schools, utilities, streets, public hospitals and other social care institutions is undeniable, and public officials feel urgent pressures to get on with this work after the enforced curtailment of capital improvements since 1941.

Many factors have operated to delay the start of really heavy capital expenditures, such as the scarcity of materials and labor, the correspondingly high costs, the time required for planning, and the usual condition that such expenditures be authorized by popular vote at regular or special elections. In a number of cases costs have risen so rapidly during the period of planning and authorization that the whole process has had to be repeated, in order to increase bond issue authorizations or to trim down the scope of the projects.

Higher Cost of Borrowing

Another influence, operating sometimes to restrain borrowing but perhaps more often to hasten it, has been the steady and relatively sharp rise of interest rates on state and municipal bonds. Yield averages which have been computed over a long period of years, such as those of the Daily Bond Buyer or the Dow-Jones Service, agree in showing about an 85 per cent rise of tax exempt bond rates between April 1946 and the present, with about half of this change occurring in the last three months of 1947. Although the rate levels are still low historically, state and local governments today are paying more for their loans than is required from any other group of borrowers affording equal security, if allowance be made for the income tax exemption obtained by investors even in the medium tax brackets.

Programs for 1948

Prospects for 1948 bear a strong resemblance to the record of 1947. Illinois has sold the remaining $78 million of its $385 million bonus bond authorization, while New York and Ohio are scheduled to borrow this month $300 million and $200 million respectively for veterans' bonus payments. It is expected that state and local borrowing for capital improvements will approximate that of 1947.

A staggering amount of public works is in the planning stage, and the tendency is to accelerate execution. Recently the Federal Works Agency reported that state and local public works contracts awarded during the first nine months of 1947 were 35 per cent higher in value than for the same period of 1946. According to the Agency, state and local-financed works approximated $1,830 million for the full year 1947, and may be increased to $2,345 million in 1948. As a graphic measure of the effects of inflation, the Agency estimates that the 1947 total new construction (both public and private) of $12.7 billion would scale down to $6.5 billion in 1939 dollars, representing a physical volume comparable with that of 1940, and appreciably lower than the level of the late 1920s.

Some Postponement Desirable

Despite the wartime debt reduction achieved by state and local governments, and with full appreciation of the public pressure to catch up on deferred improvements, present conditions of maximum employment and inflated costs make desirable postponement of all but the most urgently needed public works. The principle of fitting governmental capital expenditures into slack periods, as a means of "leveling off" the business cycle, has, unfortunately, been honored more as an excuse for making work during depressions than as two-way adjustment.

During the war, with projects screened by allocation of labor and building materials, much intelligent planning was done by the states and their municipalities for improvements whose execution would help to take up the expected slack when we should convert back to peace. As the "slack" has not yet developed, public works executed now are competing with the efforts of private business to meet long unsatisfied consumer wants, industrial plant rehabilitation, and our foreign-aid commitments.

It is true that growth and shifts of population have produced many non-deferrable needs. Some public works are of urgent importance for improving utility and transport services. In many other cases, however, government agencies might, with only moderate outlays, make present facilities do a bit longer, with the triple purposes of withholding some upward push to prices, of getting better value when costs are lower, and providing local jobs when really needed. It will not be easy, of course, for hundreds of public authorities, each acutely conscious of local needs and pressures, to restrain such expenditures, particularly on projects already authorized; but a sound and far-sighted policy on public works should pay dividends to every state and community that adheres to it.

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